

**Statement
of
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Before the

Committee on Commerce, Science and Transportation

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Mr. Chairman and members of the Committee, my name is Hardy Callcott. I am General Counsel at Charles Schwab & Co., Inc. of San Francisco, California. Thank you for the opportunity to testify on behalf of the Millenium Digital Commerce Act (S. 761). We at Schwab believe that this is good legislation and that it deserves your serious consideration and support.

Schwab is the second largest securities brokerage firm in the United States in terms of customer accounts, with over 6 million active accounts. In just three years, Schwab has become the largest online brokerage in the world, with 2.5 million active online accounts holding some \$219 billion in total customer assets. For purposes of comparison, Amazon.com currently conducts about \$3 million per day of business on its Internet website. Schwab conducts about \$2 billion of Internet commerce per day.

Online investing offers tremendous benefits to individual investors, the most important of which is better information: real-time access to investment research, market news, company press releases and SEC filings, earnings estimates and

consensus recommendations, quotes, account balances, and other investment tools such as stock screening, stock charting, and portfolio tracking. The Internet has done more to put individual investors on a level playing field with large institutional investors than any development since fixed commissions were abolished in the 1970's.

Online investing has also dramatically reduced costs for individual investors. Most online trades at Schwab cost \$29.95, compared to average commissions of several hundred dollars per trade at full-commission firms. Online investing is also convenient: customers can do research and place trades at their convenience for execution during market hours. Online investing offers speed, accuracy and control. And online investing allows customers to make their own decisions without having to trade through a broker who, especially at full-commission firms, may not have the customer's interest at heart. These factors help explain the rapid growth in customer demand for online investing.

If so much business is already being successfully conducted online, why, then, is electronic authentication legislation necessary? The answer is a simple one. Schwab and other broker-dealers need greater certainty that electronic authentication will have the same legal effect as traditional pen-and-ink signatures.

Take the simple example of account-opening procedures. Currently, customers must fill out account applications on paper, sign them manually, and then submit them in person or through the mail. With electronic authentication, this could be done entirely online and would save the industry — and, inevitably, the customer — tens, if not hundreds, of millions of dollars in operating costs. It also would be quicker and more convenient for the customer. Other transactions which require signatures and now must be handled manually could also be performed online if we are able to obtain legal assurances that electronic authentication would be recognized. These include: allowing margin trading, allowing option trading, power

of attorney forms, change of address forms, wire transfer requests, beneficiary forms, IRA distributions, and letters of authorization.

Let me address the issue of uniformity. The securities markets are national in scope and operation, and they involve transactions that are entirely interstate in nature. Schwab does business in all fifty states, and we may not even know from where a customer with a laptop is accessing our systems. Consistent and uniform federal standards are therefore imperative if brokers and others in the securities industry are to engage in electronic commerce with any degree of certainty and reliability. Congress has already recognized this reality in the area of books and records, for example, and uniformity was the impetus behind the National Securities Markets Improvement Act ("NSMIA"), adopted in the last Congress. Uniformity in electronic authentication, then, is the logical and necessary next step.

Today, patchwork regulation by the states poses the greatest barrier to the use and development of electronic signature technology and the continued evolution of e-commerce. This marketplace reality coexists uneasily with the fact that virtually every state either has already adopted or is in the process of adopting its own individualized law governing electronic authentication. The unfortunate fact is that the states have taken widely disparate approaches to electronic authentication. Thus, some states, such as in Utah's Digital Signatures Act of 1996, address the use of electronic authentication by the general public and regulate the providers of electronic authentication services through various systems of registration, licensing and payment of fees. On the other hand, several states have adopted laws that regulate only transactions with the state government. An example of this approach would be the Florida Electronic Signature Act of 1996.

Beyond these two basic formats, state laws take varying approaches with respect to such matters as registration of certificate authorities and the definition of "digital signature" and other basic terms. They contain varying treatment of

licensed and unlicensed certificate authorities, differing fee payment schemes, different rules for suspension of certificates, varying treatment of liability between parties, divergent standards for agreement between parties on the use of electronic formats, and similar considerations. Some of these state laws favor particular technologies, such as public key infrastructure, or "PKI," technology, while others are technology-neutral.

One important effort to rectify the problem of conflicting state laws is the Uniform Electronic Transactions Act ("UETA"), sponsored by the National Conference of Commissioners on Uniform State Laws, due to be presented to state legislatures later this year. We enthusiastically endorse this effort. However, there is no assurance that it will be adopted by all or even a majority of states, or that it will be achieved in a reasonable time frame. It is worth recalling that it took eleven years (from 1958-1967) for the Uniform Commercial Code ("UCC") to be adopted nationally, and even then two jurisdictions, Louisiana and the District of Columbia, failed to adopt it. Very simply, the electronic commerce industry does not have the luxury of that kind of time. We need federal action now to allow us to go forward with certainty and clarity in the marketplace.

We are therefore pleased that Members of Congress, on both sides of the political aisle, including the Leadership of both bodies, have made electronic authentication legislation a policy priority in this Congress. In particular, we want to congratulate both Senator Abraham and Chairman McCain, among others, for the introduction of S. 761 and S. 921 in the Senate, as well as Congressman Tom Bliley of Virginia, the Chairman of the House Commerce Committee, who has kicked off the debate in the House through the introduction of his bill, H.R. 1714.

In our view, it is essential that these bills be quickly considered and acted upon, and that federal legislation, such as S. 761 proposes, be put in place to provide the uniformity we need without usurping traditional state functions or

continued efforts at the state level to address these issues. Indeed, we believe that, while the states should continue to proceed on a parallel track through UETA, S. 761 now represents a careful and sensitive balancing of needs between those of the industry and the legitimate needs of the states, and it is a measure that can and should be supported by all parties.

I would like now to focus briefly on some of the main attributes of the legislative approach that we support. In its July 1, 1997, Framework for Global Electronic Commerce, the administration called for a predictable, minimalist, consistent and simple legal environment for [electronic] commerce. We at Schwab endorse this approach to legislation in this area: that is, enabling legislation that removes existing barriers to the use of, and reliance upon, electronic signatures. We believe in the creativity and innovation of the marketplace, and we see no need for legislation that over-regulates, attempts to resolve all open issues in this area or sets up new standards or regulatory regimes. What is needed is simple legislation that constructs the framework within which the market and its participants can develop the technologies and systems that work best for our various and wide ranging needs.

Similarly, we would like to see a broad definition of electronic signature that enables market participants to choose among themselves which technology and which level of security and liability meets their individualized needs for any particular situation. In this connection, we note that the definitions in S. 761 generally follow those of UETA. Existing law does not establish minimum standards of security and liability for pen and ink signatures (for example, there are no minimum standards to make signatures harder to forge). Similarly, it seems to us, this legislation should not set minimum standards for electronic signatures. The market will quite naturally work this out, selecting the best technologies, balancing costs and risks, and inevitably reaching a result which is innovative and cost

effective, both to the broker and the customer.

In Schwab's view, technology neutrality also is critical. Technology in the electronic commerce area is evolving rapidly. Legislation must be neutral so as not to stifle continued innovation. We must allow technology to develop and compete in the marketplace. Federal legislative attempts to dictate what technology is or is not acceptable, however well-intentioned they might be, will be a prescription for failure. The administration's Framework also endorsed technology neutrality in the application of any rules affecting e-commerce. The market therefore should naturally select those technologies that work and deliver appropriate security and reliability, and it will, equally naturally, reject those which do not. Legislation that enshrines any particular technology, such as public key infrastructure, or sets standards that give one technology an advantage over others will stifle innovation at these critical early stages.

Allowing and fostering technological innovation through competitive market forces has historically worked well in all areas, particularly the securities industry. For example, in the 1975 amendments to the Securities Exchange Act of 1934 (the 34 Act), Congress mandated that the SEC follow a facilitate-but-not-design approach to overseeing the development of the national securities markets. A technology-neutral enabling statute like S. 761 would follow this same approach by facilitating the development of electronic commerce without mandating a particular system or design. We believe that such an approach will result in the same beneficial technological innovation that has made the U.S. securities markets the envy of the world.

Finally, Schwab supports separate provisions dealing specifically with the securities industry because the industry is faced with not only contract law concerns but regulatory requirements. We therefore need the certainty that electronic signatures will meet the requirements of the 34 Act, as well as the Investment

Advisers Act of 1940, while at the same time recognizing the SECs authority to provide guidance to ensure that the use of electronic signatures is consistent with investor protection. For this reason, we also support Senator Abrahams introduction of a separate but related bill, the Electronic Securities Transactions Act (S. 921).

In conclusion, Charles Schwab believes that the Millenium Digital Commerce Act (S. 761) constitutes simple, forward-looking, market-oriented legislation, precisely the kind of approach which is needed if the United States is to continue to lead the world in electronic commerce. And it is an approach that is sensitive to the concerns and interests of the states. We urge you to support and pass this bill.

Thank you.